No. 11059

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

H. F. METCALF, as Trustee in Bankruptcy of the Estate of F. P. Newport Corporation, Ltd., a corporation, bankrupt, and SECURITY-FIRST NATIONAL BANK OF LOS ANGELES,

Appellees.

PETITION FOR REHEARING.

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Appellees.

PETITION FOR REHEARING.

H. F. Metcalf, as Trustee in Bankruptcy of the Estate of F. P. Newport Corporation, Ltd., one of the appellees in the above numbered cause, earnestly petitions the Judges of the United States Circuit Court of Appeals for the Ninth Circuit for a rehearing of the said cause, and in support thereof respectfully represents:

Opening Statement.

By order of the court the appeal of the Security-First National Bank of Los Angeles in case No. 11051 and the appeal of the United States of America in case No. 11059 were consolidated for certain purposes, as more particularly disclosed by the record, and by stipulation the parties agreed that the record in case No. 11051 might be considered as a supplement to the record in case No. 11059.

On February 13, 1946, this Court filed its opinion in case No. 11051. The last paragraph of this opinion reads as follows:

> "There is no merit in appellant's contention. The trustee's obligation to pay taxes on income received by him from the trust property was imposed by law. The agreement of January 12, 1937, did not, nor did any modification thereof, relieve the trustee of that obligation. Taxes on income received by the trustee from the trust property were 'expenses of administration,' within the meaning of section 64 of the Bankruptcy Act, 11 U. S. C. A., § 104, and hence were deductible in determining what 'moneys' were payable to appellant by the trustee. The trustee was properly ordered to pay the taxes here involved out of income received or to be received from the trust property. The right of the United States to such payment is superior to any right of appellant in or to such income."

On February 18, 1946, this Court filed its opinion in the above captioned cause—that is, case No. 11059. This opinion reads in part as follows:

> "As indicated above, the order of October 17, 1944, in effect, directed that, before paying taxes on income received by him from the trust property, the trustee should pay the bank $5,264.11 out of such income. Thus, in effect, it was held that the bank's right in and to such income was superior to appellant's right to taxes thereon. We have held otherwise. The order of October 17, 1944, should not have been applied for, granted or affirmed."

Question Presented.

Reading the two opinions above mentioned in the light of the admitted facts, does the Court in the instant cause hold that the payment of the income tax to the Government shall have priority over payment to the bank of interest which is also an "expense of administration"?

Statement of Facts.

The facts which are essential to an understanding of the above mentioned opinions are briefly as follows:

Prior to adjudication in bankruptcy of F. P. Newport Corporation, Ltd., proceedings had been instituted by Security-First National Bank of Los Angeles for foreclosing its trust and selling the properties pursuant thereto, in order to liquidate an indebtedness owing to said Bank in excess of $1,350,000. The properties covered by the trust constituted in excess of 90% of the assets of the bankrupt estate; an involuntary proceeding in bankruptcy was instituted; the said Bank was restrained from proceeding with said foreclosure; H. F. Metcalf was appointed Receiver; after considerable negotiations an agreement was entered into between the Receiver, the alleged Bankrupt and the said Bank, providing for termination of the foreclosure proceeding, for liquidation of the properties covered by the said trust and payment of the indebtedness owing to said Bank in installments; on execution of said agreement (January 12, 1937) the corporation was adjudicated a bankrupt. Among other things, the said agreement provided for payment by the Trustee in Bankruptcy of interest on unpaid principal of the indebtedness owing to said

Bank at the rate of 4% per annum (rather than 7% per annum, the original trust rate), and the said agreement, as supplemented and modified, was approved by the Referee in Bankruptcy, the District Court, and this Court. (*In re F. P. Newport Corporation, Ltd.*, 98 F. (2d) 453.) Pursuant to an Order, the Trustee in Bankruptcy executed said agreement as so supplemented and modified. [R. 23-24.]

The Supplemental Agreement provided, among other things, in reference to payment of interest, as follows:

> "It is agreed that interest on said principal sum of $1,270,451.12, as provided in said agreement, up to August 1, 1937, together with the sum of $9,120.06 advanced for taxes on April 16, 1937, with interest thereon at 4% per annum from the date of such advance, to August 1, 1937, shall be added to the said sum of $1,270,451.12, and thereafter bear the same interest as said sum. It is agreed that the said sum, augmented by said above mentioned amounts, is as of August 1, 1937, the sum of $1,304,918.77. Said sum shall bear interest at the rate of 4% per annum from August 1, 1937, payable as follows:
>
> Interest Payment Extended.
>
> The first installment of said interest thereon shall be paid on or before March 7, 1938. Thereafter said interest shall be paid quarterly from March 7, 1938. If any installment of interest be not so paid, it shall bear like interest as the principal." [R. 119, Case No. 11051.]

During the course of administration the Trustee in Bankruptcy leased a portion of the property to Universal

Consolidated Oil Company. [R. 26.] Oil and gas royalties paid to the Trustee under this lease were placed in a special account and are referred to by the Court as the "trust funds."

Pursuant to said agreement and the said order of the court directing the Trustee to sign the same and carry out its provisions, the Trustee paid each quarter thereafter current interest to said Bank out of said "trust funds" until this Court determined that the Trustee was required to pay income taxes. (See *United States v. Metcalf,* 131 F. (2d) 677.) The lower court thereafter determined that these taxes should be paid out of the "trust funds." (This Court in its opinion in case No. 11051 has affirmed the lower court.) Thereupon, and pending an appeal from the order so directing payment of said taxes out of said funds, the Trustee asked instructions from the court as to whether or not he should pay to said Bank a quarterly installment of interest then due. [R. 8-11.] The Referee directed the Trustee to pay said interest. [R. 16.]

On review the District Court affirmed the order of the Referee expressly upon the grounds that the Trustee had on hand in said trust account sufficient money to pay the taxes which the court had directed be paid, and also said quarterly installment of interest, and that therefore the Government could not be prejudiced by the payment of such interest if the order directing the payment of said taxes were affirmed by this Court. [See Findings and Conclusions of District Court, R. 22-33.]

Argument.

From the foregoing it appears clear that the current interest installment due the bank was an expense of administration. This Court has held that the taxes due the Government by the Trustee were an expense of administration. Therefore in our opinion they are of equal dignity.

All expenses of administration are expressly given equal rank and placed on a parity by the provisions of Section 64 of the Bankruptcy Act, 11 U. S. C. A. 104.

In the case of *United States v. Killoren,* 119 F. (2d) 364 (a case cited by this Court in its opinion), the court says at pages 366 and 367:

> "The sole question presented by the appeal is whether or not priority may be allowed to expenses incurred in the administration of the estate by the trustee in bankruptcy over expenses including taxes, incurred during the attempted reorganization before the appointment of the bankruptcy trustee.
>
> "The provisions of the Bankruptcy Act which control the priorities to be given in distribution of the proceeds of liquidation in bankruptcy are found in Section 64, sub. a, of the Bankruptcy Act of 1898, as amended, 11 U. S. C. A. § 104, sub. a; and 11 U. S. C. A. § 502 makes the same provisions applicable to the proceedings under Chapter X. Section 64, sub. a, names the debts which are allowed priority and gives the order of payment and it is clear that strict adherence to the provisions requires that the tax claim of the United States here involved be given equal priority with administration expenses incurred by the trustee in bankruptcy. * * *

"The same question was before the Court of Appeals of the Third Circuit in Re Columbia Ribbon Co., 117 F. 2d 999, 1001, and we are in accord with the conclusions stated as follows: 'The court in determining the priority of claims against the estate is bound by the provisions of Section 64, sub. a as amended, 11 U. S. C. A. § 104, sub. a, which specify the classes of debts which are to have priority of payment over general creditors of a bankrupt estate and the order of their payment with respect to each other. Five classes of debts having priority are established. The first class includes 'the costs and expenses of administration.' Since Congress has set up no order of priority within the first class the court may not fix priorities within the class. Missouri v. Ross, 299 U. S. 72, 57 S. Ct. 60, 81 L. Ed. 46; Missouri v. Earhart, 8 Cir., 111 F. 2d 992, certiorari denied, 61 S. Ct., 43, 85 L. Ed. ..... Consequently all administration expenses, whether incurred during the reorganization period or during the liquidation period and whether for costs and expenses or for services, must share *pro rata* in the funds available for payment."

(See also cases cited on page 7 of Trustee's brief heretofore filed herein.)

This Court in its opinion cited, in addition to the *Killoren* case heretofore mentioned,

Central Hanover Bank & Trust Co. v. Philadelphia & Reading Coal & Iron Co., 99 F. (2d) 642;

Florida National Bank v. United States, 87 F. (2d) 896.

We respectfully submit that these last mentioned cases merely hold that expenses of administration incurred in a reorganization proceeding are to be paid out of current income derived during such administration from the mortgaged property, and only the remaining balance of such income shall be paid to the mortgagee to apply on the debt owing him by the *debtor corporation*. This Court has considered a similar question in case No. 11051, but no such question is involved in the instant cause, for here the *taxes* and the *current* interest are *debts* of the *trustee in bankruptcy,* and therefore *both* are *expenses of administration.*

In the case of *In re Lambertville Rubber Co.,* 111 F. (2d) 45 (cited by the Court in its opinion), it is said at pages 49-50:

> "The trustee was authorized expressly to carry on the business of the debtor. The taxes which he incurred were inescapable if that business was to be carried on. They were therefore expenses of administration when incurred. Section 77B, sub. k(5), provides that upon entry of an order of liquidation, 'debts shall be entitled to priority as provided in section 64 (104);' We are of the opinon that the word 'debts' includes expenses of administration, which are debts incurred by the trustee. These debts of the trustee included the claim of the appellant, the taxes and all other expenses of administration. All were on a parity before the entry of the order of liquidation and they remained upon a parity after the order of liquidation was filed. All were payable as expenses of administration pursuant to the provisions of Section 64 of the Bankruptcy Act as amended."

Conclusion.

We earnestly urge that this Court grant a rehearing of this cause or make clear in a modified opinion that no priority is afforded to the income taxes over other expenses of administration.

BAILIE, TURNER & LAKE,
By NORMAN A. BAILIE,
ALLEN T. LYNCH,
Attorneys for Appellee.

Certificate of Counsel.

Allen T. Lynch of counsel for H. F. Metcalf, as Trustee in Bankruptcy of the Estate of F. P. Newport Corporation, Ltd., one of the appellees, in the above entitled cause, do hereby certify that the foregoing Petition for Rehearing is, in our opinion, well founded and is not interposed for delay.

ALLEN T. LYNCH,
Attorney for Appellee.